

**STATE OF UTAH INSURANCE DEPARTMENT
FINANCIAL EXAMINATION REPORT
OF**

**PROFESSIONAL INSURANCE EXCHANGE
OF**

SALT LAKE CITY, UTAH

AS OF

DECEMBER 31, 2000

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March 8, 2002

Honorable Merwin U. Stewart, Commissioner
Utah Insurance Department
State Office Building, Room 3110
Salt Lake City, Utah 84114

In accordance with your instructions and in compliance with the insurance laws of the state of Utah, an examination of the financial condition and business affairs of

PROFESSIONAL INSURANCE EXCHANGE

of
Salt Lake City, Utah

a mutual property and casualty insurance company, hereinafter referred to as the Company, was conducted as of December 31, 2000.

SCOPE OF EXAMINATION

Period Covered by Examination

The last examination was made as of December 31, 1997. The current examination covers the period from January 1, 1998, through December 31, 2000, including any material transactions and/or events occurring subsequent to the examination date noted during the course of the examination. All phases of the examination were conducted to determine compliance with generally accepted regulatory standards and procedures in conformity with the Utah Code Annotated (U.C.A.) and Utah Administrative Code (U.A.C.).

Examination Procedure Employed

The examination included a general review and analysis of the Company's operations and the manner in which its business was conducted. In addition, assets were verified and valued, liabilities were determined or estimated, accounting records were tested and a determination of its financial condition as of December 31, 2000, was performed.

The examination relied on the findings of an actuarial firm retained by the Utah Insurance Department (Department) to review the actuarial work performed by an actuary retained by the Company to establish loss and loss adjustment expense liabilities. The examination was responsible for testing the completeness of the records and the accuracy of the underlying data used to establish account values.

A letter of representation, certifying that management has disclosed all significant matters and records, was obtained from management.

Status of Prior Examination Findings

The previous examination, performed by the Department as of December 31, 1997, decreased the Company's reported surplus by approximately \$521,053. This resulted primarily from increasing the liability on excess of statutory reserves over statement reserves. Important points and recommendations noted in the prior examination report have been addressed by the Company or have received further comment in this report.

HISTORY

General

The Company was organized as a reciprocal inter-insurance exchange and granted its original certificate of authority on September 1, 1978, pursuant to U.C.A. 31-10. As of December 31, 2000, the Company was an insurer operating under the provisions of U.C.A. Section 31A-5-108. It was managed by an attorney-in-fact under the direction of an advisory committee.

Dividends to Policyholders

During the period covered by the examination, no dividends to policyholders were paid.

Management

The Company is a mutual insurer controlled by its membership. The business matters of the Company are governed by its rules and regulations. The governing body of the Company is known as the "Advisory Committee" and was composed of the following nine committee members as of December 31, 2000:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Daniel A. Boston, DDS Logan, Utah	General Dentist
Scott H. Brown, DDS Cedar City, Utah	General Dentist
Stephen M. Burton, DMD Salt Lake City, Utah	General Dentist
Mark V. Cowley, DDS Ogden, Utah	General Dentist
<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Richard C. Engar, DDS	Attorney-in-Fact

Salt Lake City, Utah	Professional Insurance Exchange
James R. Olsen, DMD Salt Lake City, Utah	General Dentist
C. Brook Olson, DDS Ogden, Utah	General Dentist
Chris R. Simonsen, DDS Bountiful, Utah	Pediatric Dentist
Gary B. Wiest, DMD Orem, Utah	General Dentist

Officers of the Company serving at December 31, 2000, were as follows:

<u>Name</u>	<u>Title</u>
Stephen M. Burton, DMD	Chairman
C. Brook Olson, DDS	Vice-Chairman
Chris R. Simonsen, DDS	Secretary
Gary B. Weist, DMD	Assistant Secretary
Richard C. Engar, DDS	Attorney-in-Fact

Conflict of Interest Procedure

During the period covered by the examination, conflict of interest statements were completed annually by committee members or officers of the Company.

Corporate Records

For examination purposes, the minutes of the meetings of the advisory, investment and audit committees were reviewed. The minutes of the meetings of the members were also reviewed.

The minutes contained detail information about the Company including current events, officer and committee member elections, investment transactions and regulatory issues. In general, the minutes adequately approved and supported Company transactions and events. The prior financial examination report was presented to the advisory committee as required by U.C.A. §31A-2-204(8).

During 2000, the Company's rules and regulations were amended and filed with the Department pursuant to U.C.A. §31A-5-203(4), which requires copies of bylaws and amendments be filed with the commissioner within 60 days of their adoption.

AFFILIATED COMPANIES

As of December 31, 2000, the Company was a member of an insurance holding company system as defined under U.C.A. §31A-1-301(46). The Company owned 100%

of the capital stock of an insurance agency, Professional Assurance Corporation (PAC). During the examination period, the functions necessary for the subsidiary's operations were performed by Company personnel through a management agreement specifying the rights and obligations of the participants.

As of December 31, 2000, insurance holding company registrations statements were filed with the Department pursuant to U.C.A. §31A-16-105.

FIDELITY BOND AND OTHER INSURANCE

The minimum fidelity coverage suggested by the National Association of Insurance Commissioners (NAIC) for a company of the Company's size and premium volume is not less than \$75,000. As of December 31, 2000, the Company had fidelity bond coverage of \$225,000.

The Company also had additional insurance protection against loss from property, liability and medical risks.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

As of December 31, 2000, the Company's employees participated in a profit sharing plan. Also the Company provided health insurance to its full-time employees and their dependents.

STATUTORY DEPOSITS

Pursuant to U.C.A. § 31A-4-105, the Company was required to maintain a statutory deposit in an amount equal to its minimum permanent surplus of \$700,000. The statutory deposits maintained by the Company at December 31, 2000, were as follows:

<u>State</u>	<u>Security</u>	<u>Par Value</u>	<u>Market Value</u>
Utah	U.S. Treasury Bill	\$ 700,000	\$ 667,919
Utah	U.S. Treasury Note	<u>95,000</u>	<u>95,000</u>
Totals		\$ <u>795,000</u>	\$ <u>762,919</u>

INSURANCE PRODUCTS AND RELATED PRACTICES

Policy Forms and Underwriting

As of December 31, 2000, the Company issued dental malpractice insurance on an occurrence basis. The retention limits for the Company were \$100,000.

The policy issued by the Company to its insureds contained a provision which established a contingent liability on the part of the insured to a maximum of \$2,000. This same provision allowed the attorney-in-fact, with the approval of the advisory committee and the Utah Insurance Commissioner, to levy an assessment upon the insured. A levy was permitted only if the assets were insufficient to discharge the Company's liabilities and maintain its statutory deposit.

Territory and Plan of Operation

As of December 31, 2000, the Company was licensed to write professional liability risks in the state of Utah only. The Company had two producers who were licensed and appointed to transact business for the Company. One of the producers had a contract with the Company as "Attorney-in-Fact" and the other producer had a contract as "Executive Consultant."

The Company bills the insured directly for premiums. An insured covered by the Company for more than four years receives a premium discount.

Advertising and Sales Material

As of December 31, 2000, the Company's advertising materials consisted of a small advertisement in a periodic dentist publication.

Treatment of Policyholders

As of December 31, 2000, no justified complaints against the Company were received by the Department. During the examination period, the Company maintained a complaint log to monitor complaints.

REINSURANCE

Assumed:

During the period covered by the examination, the Company did not assume any reinsurance.

Ceded:

As of December 31, 2000, the Company maintained an excess of loss reinsurance agreement with an authorized reinsurer in the state of Utah. The agreement

indemnified the Company in respect to each insured under each professional liability policy written by the Company.

The Company ceded the excess of the first \$100,000 each loss, subject to a limit of liability of \$1,000,000 each claim, \$3,000,000 aggregate.

ACCOUNTS AND RECORDS

As of December 31, 2000, the Company's accounts and records, consisting of its general ledger, registers and other subsidiary records, were maintained on a combination of manual systems and electronic data processing (EDP) systems located in the Company's office and in the offices of the Company's accountants.

An examination trial balance, as of December 31, 2000, was prepared from the Company's computerized general ledger. Account balances were traced to annual statement exhibits and schedules. Individual account balances for the examination period were examined as deemed necessary.

The Company retained the services of a certified public accounting firm to audit its financial records. During the examination period, work papers evidencing the audits were made available for the examiners to review.

Some annual statement discrepancies noted during the examination include:

- The 2000 annual statement Schedule D –Part 1, did not report the rates of interest on four securities. Also, the accrued interest for one security was not reported. The absence of reporting for these securities was inconsistent with the NAIC annual statement instructions.
- The 2000 annual statement Schedule D – Part 2 – Section 2, noted two common stocks with the NAIC designation of "LZ," which did not qualify for this designation in accordance with the purposes and procedures manual of the securities valuation office (SVO), of the NAIC.
- The common stocks book value reported on Schedule D – Part 2 Section 2, was inconsistent with the NAIC annual statement instructions and industry practice. The "ledger" and "book" values of its common stocks were reported at market instead of cost. However, the overall admitted values were stated correctly.
- The 2000 annual statement balance sheet reported taxes, licenses and fees and federal and foreign income taxes in the wrong line item. This was inconsistent with NAIC annual statement instructions.

During the examination, the actuary noted discrepancies in the 2000 annual statement Schedule P, which were not consistent with NAIC annual statement instructions:

- In Part 1, Summary, \$11,000 in ceded earned premiums were booked in 2000 and attributed to the 1999 year. Assuming this is in fact 1999 ceded premium, attributing it to the 1999 year is theoretically correct, however, annual statement instructions prescribe that premium booked in 2000 be attributed to the 2000 calendar year.
- In Part 1, Summary, the gross and net loss and LAE ratios for each accident years 1996, 1997, and 1998 differ. Since these are not ceded premiums or claims for these years, gross and net ratios should be identical.
- Many of the loss and LAE ratios in columns 29 and 31 differ between Part 1, Summary and Part 1H. Since the Company only writes one line of business, these should be identical.
- In Part 1, Summary, the net incurred loss and LAE figure for accident year 2000 (Column 28, Line 11) of \$119,000 is not accurate. The figure should be \$169,000 as shown on Part 1H. Likewise, the \$119,000 figure on Part 2, Section 1, Column 10, Line 11 is not accurate.
- Data included in the prior lines of Parts 2, 3, 4 do not appear to be reasonable given the significance of change across the row.
- In Part 3H, Section 1, claim counts in Columns 11 and 12 appear to be incremental rather than cumulative. They should be cumulative.
- In Part 5H, Section 1A, claim counts in Column 10 appear to be incremental when they should be cumulative. Also, for the 1994 accident year, information in Sections 1A, 2A, and 3A indicate that one claim was closed with loss payment during 2000 but the number of open claims and reported claims did not change from year end 1999 to 2000. This is inconsistent.
- In Part 6 H, Sections 1 and 2 should show the same premiums across the rows as shown in the first diagonals since these triangles display cumulative earned premiums for each calendar year.
- In Part 7A, the Company shows \$510,000 in Column 2 as the amount of reserves for loss sensitive contracts. Since the Company does not write loss sensitive contracts, this figure should be \$0.

U.C.A. §31A-4-113, requires each authorized insurer to file a true statement of its financial condition and affairs as of December 31 of the preceding year in accordance with the annual statement instructions and the accounting practices and procedures published by the NAIC. According to the NAIC annual statement instructions, a

statement is not considered filed unless the information therein is complete and accurate.

FINANCIAL STATEMENT

The following financial statements are included in the examination report:

Balance Sheet as of December 31, 2000

Summary of Operations for the Year Ended December 31, 2000

Capital and Surplus for the Years 1998 through 2000

The Comments on Financial Statement immediately following the financial statements are an integral part of the statements.

Professional Insurance Exchange
Balance Sheet as of
December 31, 2000

ASSETS

	<u>Amount</u>	<u>Notes</u>
Bonds	\$ 707,941	
Common stocks	3,355,750	
Cash and short-term investments	1,130,341	
Electronic data processing equipment	397	
Interest, dividends, and real estate income due and accrued	10,021	
Aggregate write-ins for other than invested assets:		
Reinsurance prepaid	<u>0</u>	(1)
 TOTAL	 <u><u>\$ 5,204,450</u></u>	

LIABILITIES, SURPLUS AND OTHER FUNDS

Losses	\$ 200,000	
Loss adjustment expenses	310,000	
Other expenses	14,538	
Taxes, licenses and fees	8,735	
Federal and foreign income taxes	4,516	
Unearned premiums	395,411	
Amounts withheld or retained by company for accounts of others	5,877	
Excess of statutory reserves over statement reserves	701,600	(2)
 TOTAL LIABILITIES	 <u><u>1,640,677</u></u>	
 Unassigned funds	 <u>3,563,773</u>	
Surplus as regards policyholders	<u>3,563,773</u>	(3)
 TOTAL	 <u><u>\$ 5,204,450</u></u>	

Professional Insurance Exchange
Summary of Operations
for the Year Ended December 31, 2000

UNDERWRITING INCOME

	<u>Amount</u>
Premiums earned	\$ 755,252
Deductions:	
Losses incurred	48,718
Loss expenses incurred	275,715
Other underwriting expenses incurred	<u>212,705</u>
Total underwriting deductions	<u>537,138</u>
Net underwriting gain	<u>218,114</u>

INVESTMENT INCOME

Net investment income earned	<u>299,987</u>
Net investment gain	<u>299,987</u>

OTHER INCOME

Aggregate write-ins for miscellaneous income: management fees	<u>33,656</u>
Total other income	<u>33,656</u>
Net income before dividends to policyholders and before federal income tax	551,757
Dividends to policyholders	<u>0</u>
Net income after dividends to policyholders but before federal income taxes	551,757
Federal income taxes incurred	<u>86,516</u>
Net income	<u>\$ 465,241</u>

Professional Insurance Exchange
Capital and Surplus
for the Years 1998 through 2000

	<u>1998</u>	<u>1999</u>	<u>2000</u>
Surplus as regards policyholders, December 31 Prior year	\$ 3,520,455	\$ 3,197,790	\$ 3,280,009
Net income	392,215	218,697	465,241
Net unrealized capital gains or (losses)	(34,231)	(239,209)	(3,523)
Change in nonadmitted assets	3,751	7,131	(65,154)
Change in excess of statutory reserves over statement reserves	<u>(684,400)</u>	<u>95,600</u>	<u>(112,800)</u>
Change in surplus as regards policyholders for The year	<u>(322,665)</u>	<u>82,219</u>	<u>283,764</u>
Surplus as regards policyholders, December 31 Current year	<u>\$ 3,197,790</u>	<u>\$ 3,280,009</u>	<u>\$ 3,563,773</u>

COMMENTS ON FINANCIAL STATEMENT

(1) Aggregate write-ins for other than invested assets \$ 0

As of December 31, 2000, the Company reported \$69,211, as prepaid reinsurance. This was not a qualified asset pursuant to U.C.A. § 31A-17-201(2), and was not recognized for examination purposes.

(2) Excess of statutory reserves over statement reserves \$701,600

The Company reported a statutory reserve liability amount of \$569,900. The examination determined the liability to be understated by \$131,700.

(3) Surplus as regards policyholders \$3,563,773

The Company's surplus as regards policyholders was determined to be \$200,911, less than reported in the Company's annual statement as of December 31, 2000. The following schedule identifies the examination changes:

<u>Description</u>	Annual Statement <u>Dr (Cr)</u>	Per <u>Examination</u>	Change in Surplus <u>Inc. (Dec.)</u>	<u>Notes</u>
Aggregate write-ins for other than invested assets	\$ 69,211	\$ 0	\$ (69,211)	(1)
Excess of statutory reserves over statement reserves	569,900	701,600	(131,700)	(2)
Total changes			(200,911)	
Surplus as regards policyholders per Company			3,764,684	
Surplus as regards policyholders per Examination			<u>\$ 3,563,773</u>	

U.C.A. §31A-5-211, requires the Company to maintain permanent surplus in the amount of \$700,000. In accordance with U.C.A. 31A-17-VI, the Company reported total adjusted capital of \$3,764,684, and its authorized control level risk-based capital (RBC) requirement of \$512,161, as of December 31, 2000.

The examination determined total adjusted capital to be \$3,563,773, and the authorized control level RBC to be \$512,161. The surplus as regards policyholders, as determined by the examination of \$3,563,773, substantially exceeded both the permanent surplus required by U.C.A §31A-5-211 and the RBC requirements of U.C.A. 31A-17-VI.

SUMMARY COMMENTS AND RECOMMENDATIONS

Items of significance or special interest contained in this report are summarized below:

1. Annual statement reporting deficiencies during the examination were noted.
(ACCOUNTS AND RECORDS)
2. As of December 31, 2000, the Company reported \$69,211, as prepaid reinsurance. This was not a qualified asset pursuant to U.C.A. § 31A-17-201(2), and was not recognized for examination purposes. (COMMENTS ON FINANCIAL STATEMENT – Note 1, Aggregate write-ins for other than invested assets)
3. The Company reported excess of statutory reserves over statement reserves liability in the amount of \$569,900. The examination determined the liability to be understated by \$131,700. (COMMENTS ON FINANCIAL STATEMENT – Note 2, Excess of statutory reserves over statement reserves)
4. Total surplus as regards policyholders of the Company was \$200,911, less than reported in the Company's annual statement as of December 31, 2000. The Company's surplus as regards policyholders of \$3,563,773, substantially exceeded both the permanent surplus required by U.C.A §31A-5-211 and the RBC requirements of U.C.A. 31A-17-VI. (COMMENTS ON FINANCIAL STATEMENT – Note 3, Surplus as regards policyholders)

CONCLUSION

The assistance and cooperation extended during the course of the examination by officers, employees and representatives of the Company are acknowledged. In addition to the undersigned, Mr. R. Glenn Taylor, A.C.A.S, M.A.A.A., of Taylor-Walker & Associates. Inc., conducted the actuarial phases of the examination.

Respectfully submitted,

David A. Martinez, CFE
Examiner in Charge, representing the
Utah Insurance Department